

***United States Court of Appeals
for the Second Circuit***



**PETITION FOR
REHEARING
EN BANC**

77-1342

UNITED STATES COURT OF APPEALS
For the Second Circuit

No. 77-1342

UNITED STATES OF AMERICA,

Appellant,

v.

DOUGLAS P. FIELDS, FREDERICK M. FRIEDMAN,
PETER S. DAVIS, ALAN E. SANDBERG, and
ERIC BERGE,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE SOUTHERN
DISTRICT OF NEW YORK

PETITION FOR REHEARING WITH A
SUGGESTION FOR REHEARING EN BANC

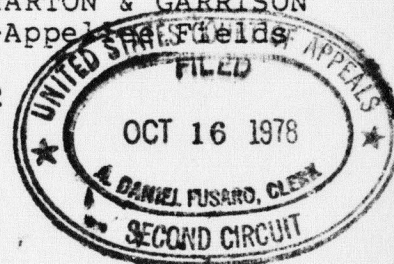
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Defendants-Appellees Fields and Sandberg petition this Court, pursuant to Rules 35 and 40 of the Federal Rules of Appellate Procedure, for rehearing, with a suggestion of rehearing en banc, of a decision of a panel of this Court (Feinberg, Mansfield and Timbers, JJ.), dated September 14, 1978. Judge Mansfield wrote a separate concurring opinion. The Panel's decision reversed an order of the District Court (Haight, J.) (which had dismissed substantial portions of the

indictment) and remanded the case with a direction to reinstate the unexpurgated indictment.*

Preliminary Statement

Respect for the rule of law and for basic principles of fairness has frequently required courts to dismiss indictments, as Justice Cardozo said, merely because the constable blundered. The case for dismissal of the indictment here surely was a fortiori. This is not a case in which the constable merely "blundered": here, rather, two government lawyers engaged in what was found to be a "calculated and deliberate" course of "deceitful and duplicitous" misconduct in their admitted efforts "to get" the defendants.

Yet, a Panel of this Court has held that the District Court's dismissal of the indictment on account of such egregious government behavior was not within the District Court's discretion.

We respectfully submit that the Panel has seriously erred, and its errors include misapprehension of uncontested facts and controlling legal principles -- factors that traditionally warrant rehearing. Specifically, rehearing should be granted in this case because:

* References herein to the Panel's decision are to the Slip Opinion ("Sl. Op."). The District Court's opinion is reported at CCH Sec. L. Rep. ¶ 96,074. References to that opinion are to the CCH report.

1) A major portion of the Panel's decision -- indeed, nearly a third of the printed opinion -- is expressly premised upon a critical mistake of fact (pp. 3-10, infra);

2) The Panel has greatly expanded the disclosure requirements of the federal securities laws, in conflict with the decisions of other panels of this Court and of numerous other courts (pp. 11-20, infra);

3) As to the issue which the Panel termed the "chief issue" on appeal -- whether the government's misconduct was sufficiently egregious to permit Judge Haight to dismiss the indictment -- the majority's opinion overlooks key, undisturbed findings of the District Court and, in consequence, misapplies pertinent law, and the concurring opinion overlooks the very significant prejudice suffered by defendants in the criminal case as a result of the government's misconduct (pp. 21-29, infra).

REASONS FOR GRANTING
THE PETITION

I. A Major Portion of the Panel's Decision
Is Based Upon a Critical Mistake of Fact.

In late 1975, while they were deceiving defendants into believing there would be no criminal reference, and while they were fraudulently extracting from the defendants a "superb" SEC settlement, two junior SEC lawyers -- Tucker and Perlmutter -- referred the case against defendants to the United States Attorney. The reference was made without the

approval (or knowledge) of the Commission or even of senior SEC staff or counsel.

Defendants showed in their main briefs that applicable SEC statutes and regulations require that the Commission itself must approve a criminal reference -- unless the Commission has expressly delegated such authority under published regulations or rules. There was no such delegation here, and thus the criminal reference by junior SEC staff lawyers acting without authority violated the SEC statutes and rules. The indictment therefore was unlawfully initiated and must be dismissed.*

The Panel rejected this contention. (Sl. Op. 4727-32) It held that the requirement of Commission approval for a criminal reference does not apply in cases of informal or preliminary SEC investigations. It assumed that the investigation here was an informal one and therefore held the reference was not contrary to law. The Panel said, for example:

"It is important to bear in mind the distinction, under SEC procedure, between an informal investigation (such as that here involved) and a formal investigation;" (Sl. Op. 4727; emphasis in original)

* See discussion and authority cited at pp. 5-9 of the Reply Memorandum of Appellees Fields and Friedman to the SEC amicus brief and at pp. 10-31 of the Brief of Appellee Sandberg.

"In the instant case, the SEC investigation never proceeded beyond the preliminary stage."
(Sl. Op. 4731)

In point of undisputed record fact, however, the SEC investigation here was a formal investigation -- conducted pursuant to an order of the Commission dated February 19, 1975. (District Court Opinion at 91,840)

The Panel thus was clearly wrong on the facts. And despite the government's predictable effort now to minimize the importance of that factual error,* it is evident from the opinion itself that the Panel's misapprehension of fact was central to its reasoning.

The Panel reasoned as follows:

1) Although the Securities Act of 1933 and the Securities Exchange Act of 1934, 15 U.S.C. §§ 77t(b) and 78u(d) (1976), explicitly vest in the Commission the authority to refer cases for criminal prosecution (Sl. Op. 4729, lines 1-6), another statute (15 U.S.C. § 78d-1(a) (1976)) authorizes the Commission to delegate its functions to its staff. (Sl. Op. 4729, lines 6-9)

2) Under Section 171 of the SEC's Manual of Administrative Regulations, the Commission has delegated to certain senior officials the authority to make disclosures

* Letter to the Panel from Jed S. Rakoff, Esq. dated October 10, 1978.

of non-public information to other federal law enforcement officials such as a United States Attorney.* (Sl. Op. 4730, lines 1-9) This authority, in turn, has been properly redelegated to "lower echelon" attorneys.** (Sl. Op. 4731)

3) Therefore, the Panel concluded, Tucker and Perlmutter had authority to refer the SEC file to the United States Attorney. (Sl. Op. 4731)

But, the very sections of the SEC Manual upon which the Panel relies for its determination (in step 2 above) that there has been a delegation of authority by the Commission to senior SEC staff explicitly excludes information developed in the course of a formal SEC investigation. Thus, § 171.06 of the Manual (upon which the Panel relied) provides:

" Commission officials [elsewhere defined to mean only specified senior officers] are authorized in their discretion to make information developed in the course of their investigations, other than formal investigations which have been ordered by the Commission, and other non-public information available to [other law enforcement agencies]." (Sl. Op. 4730, fn. 18; emphasis added)

And § 171.07 (upon which the Panel also relied) provides:

* In fact, the rules in this internal SEC Manual are not published and thus would not constitute a lawful delegation under the Code of Federal Regulation.

** In fact, such asserted "redelegation" was never made in any writing or official act and thus there has been no lawful delegation under the Code of Federal Regulation.

" . . . Commission officials are authorized in their discretion to make available to Federal and State law enforcement to Federal and State law enforcement [sic] agencies information developed in the course of an investigation other than a formal investigation which has been ordered by the Commission. . . ." (Sl. Op. 4731, fn. 18; emphasis added)

The very next section, § 171.08, of the Manual -- a section obviously not considered by the Panel because the Panel believed this was an informal investigation -- provides that in the case of a formal investigation, the SEC staff may only "recommend to the Commission that information be turned over to such [law enforcement] authorities." (Emphasis added)

The SEC investigation here was a formal investigation, and under the above-quoted words of the unpublished Manual, the Commission did not delegate to Perlmutter and Tucker authority to disclose to the U.S. Attorney information developed in the course of the SEC's formal, private investigation.

In short, the very rationale for the Panel's conclusion that the criminal reference in this case was lawful is simply erroneous.* And thus the Panel's own interpreta-

* The government engages in a seriously misplaced effort, in its letter of October 10, 1978, to make light of the Court's factual error. The government first cites a sentence in which the Panel said that the Manual authorizes SEC officials' disclosure of non-public information to other law enforcement officials "even when it has been developed in other than a formal investigation." (Emphasis in government's letter) The Government then reasons: "A fortiori, such disclosure is wholly proper where it results, as here, from a formal investigation that the Commission itself has authorized." (Emphasis in government's letter)

(Continued)

tion of the SEC statutes and regulations it deemed relevant requires a holding that the two SEC staff members here unlawfully usurped the Commission's authority.

Further, SEC regulations and record facts which the Panel overlooked make the staff members' usurpation of authority even more flagrant.

The undisturbed findings of the District Court show that Perlmutter and Tucker did more than simply refer an SEC private investigative file for possible criminal prosecution, as the Panel's opinion characterizes their conduct. (Sl. Op. 4726) Judge Haight's findings show that they actively recommended, stimulated -- indeed exhorted -- the United States Attorney to prosecute. On September 16, 1975, Tucker called an Assistant United States Attorney and said "we really want to get" the defendants (emphasis added). (District Court Opinion at 91,842) He and Perlmutter followed up that call with repeated additional calls in October, November, and December urging the prosecutor to proceed criminally (Id. at 91,842-43) -- all the while urging the prosecutor to delay only long enough to lull the defendants into accepting what Tucker in his testimony termed "superb" sanctions in the SEC settlement. (Tr. 995-999)*

(Continued)

The simple answer to the government's "lawyer's logic" is the text of the Manual quoted above -- the very words upon which the Panel relies in the sentence from the opinion noted by the government. That text specifically excludes information developed in the course of a formal investigation from the authority allegedly granted to SEC officials to disclose non-public information.

* "Tr." refers to the transcript of the evidentiary hearing held by the District Court.

Under the SEC's published regulations it is not within the province of staff, such as Tucker and Perlmutter, to recommend criminal prosecution. The Commission recognizes how awesome is the power so to recommend and expressly vests in two senior SEC officials, the Director of the Division Enforcement and the General Counsel -- who are required to act in consultation -- the responsibility to review each case before a recommendation for prosecution is made to the Justice Department.

Thus, 17 CFR § 200.19(b) provides, in relevant part:

" [T]he Director [of The Division of Enforcement] is responsible, in collaboration with the General Counsel, for the review of cases to be referred to the Department of Justice with a recommendation for criminal prosecution." (Emphasis added)

And 17 CFR § 200.21 provides, in relevant part:

"He [the General Counsel] is responsible, in collaboration with the Division of Enforcement, for the review of cases to be referred to the Department of Justice with a recommendation for criminal prosecution." (Emphasis added)

Here, there was no review by either the Director of the Division of Enforcement or the General Counsel (not to say consultation between them). (Tr. 708-9; 717) Indeed, prior to the reference, the Director of the Division of Enforcement had not even heard of the case! (Tr. 674) Two junior staff members, acting entirely on their own initiative, called the U.S. Attorney, recommended and urged prosecution, and said -- without any authority whatever -- "we really want to get" the defendants. (District Court Opinion at 91,842)

The required review by senior officials, such as Stanley Sporkin, Esq., was particularly important in a case such as this when two junior staffers have behaved "fraudulently." (See discussion at pp. 21-29, infra.)

The conduct of Messrs. Perlmutter and Tucker was not only "deceitful and duplicitous," as Judge Mansfield said in his concurring opinion; their conduct in instigating the indictment was absolutely beyond the pale of the law.

We recognize that both the Panel (Sl. Op. 4731-4732) and Judge Haight below (District Court Opinion at 91,848) expressed reluctance to invalidate the criminal reference here and thereby to invalidate a working relationship that has developed between the SEC and the U.S. Attorneys in recent years.

To do justice to the defendants in this case, however, the Court need not go so far as to invalidate that working relationship. It need only hold -- and under the express words of the applicable statutes and regulations ' should hold -- that where, as here, after a formal order of investigation junior SEC staff decides to make a referral and recommendation for criminal prosecution, such a decision must be reviewed by the General Counsel "in collaboration with" the Director of the Division of Enforcement (17 CFR §§ 200.19(b) and 200.21) and must receive final approval of "the Commission." (15 U.S.C. §§ 77t(b) and 78u(d))

Since there was no such review or approval in this case, the indictment was unlawfully initiated and should be dismissed.

II. The Panel's Decision Conflicts With Decisions of Other Panels of this Court and Creates Clearly Erroneous SEC Disclosure Standards.

The Panel's reversal of Judge Haight's "alternative grounds" for dismissing portions of the indictment conflicts with the numerous cases which hold that a corporate director is not required first to reach legal conclusions with which he disagrees, and then to "disclose" such conclusions in SEC filings. To fully appreciate this conflict, it will be helpful to recall the background to the District Court's alternative holding and the Panel's reversal of that holding.

A. The Background

The heart of the alleged wrongdoing by defendants concerns the so-called "ERD transactions" and "Westcalind transaction." The ERD transactions were two sales of TDA letter stock in April and May, 1971 by 15 TDA shareholders. The Government contends that defendants Fields, Friedman and Davis refused to "free-up" restrictions on that stock and at the same time allegedly engineered its sale to a third party, who sold the stock on the open market at a profit of \$435,000. Defendants, it is alleged, received 70% of this profit, or \$300,000. The Panel characterized the transaction as an alleged fraud upon those 15 selling shareholders (not upon TDA). (Sl. Op. 4738)

As to the "Westcalind transaction," the Government claims that in March, 1971, the defendants caused Westcalind, a

separate public company in which TDA owned 32% of the stock, to pay a \$50,000 finders' fee to a third party, who allegedly did not earn the fee and "kicked back" \$35,000 to the defendants. (Sl. Op. 4720)

In late 1975, Perlmutter and Tucker referred this case to the U.S. Attorney's office and recognized that there was a serious "statute of limitations problem" and so advised the prosecutor (A. 205),* as the five-year statute on the transactions which were being referred would run by March, April and May, 1976. But Perlmutter and Tucker themselves aggravated that limitations "problem" by urging the prosecutor to deliberately wait in order to permit Perlmutter and Tucker deceptively to extract the "superb" SEC settlement from the defendants. (District Court Opinion at 91,842-4)

Thus, when the U.S. Attorney finally presented his indictment to the grand jury in November 1976, the case that had been referred to him already was time-barred. In order to prosecute, therefore, he was forced to strain to find a means by which to circumvent the limitations bar and allege some other colorable violation which would embrace the ERD and Westcalind transactions. The resulting indictment was just such a strained effort to circumvent the statute of limitations.

Unable to charge defendants with the crime of committing the ERD and Westcalind transactions, the government

* "A." refers to the Joint Appendix filed in this Court.

charged defendants with the alleged crime of failing to disclose their alleged earlier wrongdoing. Thus, the November, 1976 indictment as filed charges defendants Fields, Friedman, and Davis with a conspiracy to commit securities fraud in November and December, 1971 by filing a TDA prospectus and a TDA proxy statement which did not disclose the earlier ERD and Westcalind transactions. The prospectus at issue was filed in conjunction with a November, 1971 public sale of 703,943 shares of TDA stock. The proxy statement was used in December, 1971 to solicit proxies for the voting at a January, 1972 TDA annual meeting that would elect three directors and change TDA's stock option plan.

The government's theory below was in essence that the ERD and Westcalind transactions were unlawful acts by TDA directors and therefore were on their face material to the Corporation and should have been disclosed in both the prospectus and the proxy statement. The District Court rejected that theory and held that these March, April and May, 1971 transactions had nothing to do with TDA's financial position in November, 1971 and were unrelated to the matters for which proxies were solicited in December, 1971; accordingly, no violation was committed by not disclosing them in the filings. (District Court Opinion at 91,853-57)

On appeal, the government changed -- and strained even further -- its already-strained theory of required SEC

disclosure, and the Panel, we regret to say, appears simply to have adopted the government's new theory without analysis. In so doing, the Panel seriously erred.

B. The Panel's Holding on
the ERD Transactions

1. The Prospectus

The Panel, adopting the government's new, appellate theory almost in haec verba, held that the ERD transactions were material to TDA and thus were required to be disclosed in the November, 1971 TDA prospectus because:

Defendants' \$300,000 profit on this transaction, while ultimately coming out of the pockets of the defrauded stockholders, may well be immediately recoverable by TDA, Inc. as a short swing purchase and sale under Section 16(b) of the 1934 Act, 15 U.S.C. § 78p(b) (1976). (Sl. Op. 4738; emphasis added)

There are only two possible interpretations of this reasoning in the Panel's opinion. Either (a) the Panel was saying that defendants had engaged in a possible 16(b) violation and ipso facto they were required to disclose that potential violation or (b) it was saying that this possible violation created a potential asset for TDA and that potential asset was required to be disclosed as material to TDA's financial condition.

Both of these interpretations present the same analytical defect and the same conflict with other decisions.

The fact is that the defendants hotly dispute as a matter of law that 16(b) even applies to the ERD transactions -- much less that they incurred any 16(b) liability or that they owed \$300,000 to TDA.* And at the time the prospectus was filed no litigation had been commenced asserting that defendants had committed a 16(b) violation; indeed to this day there has been no such litigation other than the government's new appellate criminal theory. Even the SEC in its lengthy civil complaint made no such claim.

That being so, both possible interpretations of the Panel's holding would require defendants (a) to draw a legal conclusion they dispute and then (b) to "disclose" that legal conclusion in a TDA prospectus.**

Such a "disclosure" requirement necessarily conflicts with the numerous cases in this Circuit and others which hold that officers and directors are not required to make, and then disclose, conclusions that they violated the law. See, e.g., Browning Debenture Holders Committee v. DASA Corp., 560 F.2d 1078, 1084 (2d Cir. 1977) (No requirement to disclose that corporate conduct may be a violation of state law.); Ashe v. LFE Corp., 525 F.2d 215 (3rd Cir. 1975) (No requirement to disclose that corporate conduct may be ultra vires.); Laurenzano v. Einbender, 448 F.2d 1 (2d Cir. 1971), aff'g, 264 F. Supp. 356,

* See, e.g. pp. 57 to 62 of Brief for Appellees Field and Friedman.

** Or worse still, to adopt that legal conclusion (contrary to their own view) and then calculate TDA's assets on the basis of a legal conclusion they regard as erroneous.

361 (E.D.N.Y. 1966) (No requirement to disclose alleged breaches of fiduciary duty.); Freedman v. Barrow, 427 F. Supp. 1129, 1144 (S.D.N.Y. 1976) ("Failure to disclose a legal theory with which those soliciting [proxies] disagree . . . does not violate" federal disclosure laws.); Limmer v. General Telephone & Electronics Corp., CCH Fed. Sec. L. Repr. ¶ 96,111 (S.D.N.Y. 1977); Walner v. Friedman, 410 F. Supp. 29, 32 (S.D.N.Y. 1975); Robbins v. Banner Industries, Inc., 285 F. Supp. 758, 762 (S.D.N.Y. 1966) (No requirement to disclose allegedly "fraudulent activity.")

And directors are not required to predict the commencement or outcome of not-yet-commenced litigation alleging that they violated the law. "It would be an interesting legal theory indeed to impose upon a corporation the duty to disclose . . . not-yet-existent litigation." Shapiro v. Belmont Industries, Inc., 438 F. Supp. 284, 292 (E.D. Pa. 1977).

Only by the holdings in these and many other similar cases have courts been able to halt the "disturbing"* trend -- a trend in which stockholder plaintiffs have tried to flood the federal courts with attempts to convert state-law waste or breach-of-fiduciary duty claims into asserted violations of the federal securities laws by alleging that the directors failed

* Ryan v. J. Walter Thompson Co., 453 F.2d 444, 445 (2d Cir. 1971), cert. denied, 406 U.S. 907 (1972).

to disclose in some SEC filing that they had violated the law or had committed waste.*

The decision of the Panel here seriously threatens to revive that "disturbing" trend. The plaintiff in the garden variety derivative suit for corporate waste now may get into federal court simply by alleging, in the words of the Panel, that the directors failed to disclose in some SEC filing that the Corporation "may well immediately recove[r]" for the directors' alleged waste, breach of fiduciary duty, or other alleged violation of law.

Thus the courts (including this Court) heretofore have uniformly held -- and properly so -- that until litigation which could have a material impact on the corporation has been commenced, or until there has been a court finding of director misconduct vis-a-vis the corporation, there is no requirement that a director "disclose" (or assume) that he committed an asserted violation of law.

The Panel's decision here implicitly -- but necessarily -- conflicts with those cases and creates bad new law.

There is another substantial difficulty with the Panel's holding that the alleged \$300,000 short swing ERD "profit" was required to be disclosed because it was material

* Such attempts to expand federal securities law jurisdiction have been viewed with extreme displeasure by the Supreme Court. See, e.g., Green v. Santa Fe Industries, Inc., 430 U.S. 954 (1977).

to TDA. At most, this is a contingent -- and speculative -- asset which defendants deny they owe to TDA. And the record shows that TDA's assets in 1971 totalled \$18,681,657.

(A. 135) The contingent asset not disclosed thus amounted to 1.6% of TDA's assets. We know of no case in which an understatement of 1.6% of even hard assets was held to be material. It is more difficult still to understand how non-disclosure of such a relatively minuscule contingent asset is material.

In sum, the government strained the law far too much in trying to subsume the time-barred ERD transactions in a claimed violation of SEC disclosure requirements. And the Panel, in adopting that strained theory, created conflict with heretofore consistent and correct authority.

2. The Proxy Statement

The Panel held that defendants violated § 14(a) of the 1934 Act* because the TDA proxy statement of December, 1971 did not comply with Item 7(e)(4) of Schedule 14A.** The Panel said:

"Item 7(e)(4) of Schedule 14A, 17 C.F.R. § 240.14a-101 (1977), requires disclosure of:

'indebted[ness] to the issuer . . . [of e]ach director or officer of the issuer . . . [including] any indebtedness . . . [which] arose under Section 16(b) of the [Securities Exchange] Act. . . .'

* 15 U.S.C. 78n(a) (1976).

** 17 C.F.R. § 240.14a - 101(f) (1977).

"Defendants' sale of TDA shareholders' lettered stock immediately after acquiring it in a private placement -- the ERD kickbacks -- clearly would violate Section 16(b). Accordingly, their failure to disclose these kickbacks, if proven, would constitute a violation of Item 7(e)(4) and consequently of Section 14(a)." (Sl. Op. 4740; emphasis added)

As noted above, the defendants deny any such 16(b) liability and deny any such indebtedness.* Thus, the Panel's holding once again would require defendants (1) to draw a legal conclusion they dispute and (2) to "disclose" that conclusion. Once again, the Panel's decision inevitably conflicts with the authorities cited at pages 15-16, supra.

C. The Westcalind Transaction

Again adopting the Government's appellate theory almost in haec verba, the Panel held that defendants' failure to disclose the Westcalind transaction in the TDA 1971 proxy statement violated Item 7(f) of Schedule 14A and thus violated § 14a. The Panel reasoned:

"Item 7(f) of Schedule 14A, 17 C.F.R. § 240.14a-101(f) (1977), requires disclosure of:

'any transactions since the beginning of the issuer's last fiscal year . . . to which the issuer or any of its subsidiaries was or is to be a party, in which any of the following persons had or is to have a direct or indirect material interest . . .
(1) Any director or officer of the issuer; (2) Any nominee for election as a director. . . .' [Emphasis in original]

"If proven, defendants' failure to disclose their interest in the Westcalind kickbacks certainly would be a violation of Item 7(f) and consequently of Section 14(a)." (Sl. Op. 4739-40)

* And the SEC civil complaint alleged no such § 16(b) violation or § 14(a) violation.

The Panel thus premised its holding on an assumption -- taken entirely from the government's wholly unsupported characterization in its brief on appeal -- that Westcalind was a TDA "subsidiary."

In point of record fact, Westcalind was not a TDA "subsidiary." Westcalind is a separate public company and at the relevant times TDA owned no more than 35% of its stock. (A. 139) Westcalind was not treated as a subsidiary in TDA's independently-audited financial statements; the stock was carried only as an investment. (District Court Opinion on rehearing at 92,001 and A. 135 and 139) This is also true for TDA's SEC filings. And the financial statements of the two companies were not consolidated. (District Court Opinion on rehearing at 92,001 and A. 130-148)

In short, Westcalind was not a TDA subsidiary; accordingly, there was no violation of Item 7(f); hence, on the Panel's own reasoning, there was no violation of Section 14(a).

And if there be any factual issue as to the corporate status of Westcalind, the government is barred in this Court from raising it. The government did not argue below that defendants violated Section 14(a) because Westcalind was a subsidiary and defendants therefore violated Item 7(f). The government's newly-created theory to that effect should never have been considered by this Court. As another Panel of the Court said:

"[W]e see no reason to depart from . . . the general rule of practice which forecloses appellate consideration of issues not raised below. . . . (citation omitted) Adherence to the rule is particularly apt where, as here, factual questions may have been implicated as to which the judge made no findings because the issue was not directly raised and equally, where considerations underlying a subtle legal issue could have been exposed and distilled by the able district judge so as to facilitate more informed consideration by this court." Terkildsen v. Waters, 481 F.2d 201, 204-05 (2d Cir. 1973) (emphasis added)

III. The Panel Overlooked Key, Undisturbed Findings of Fact Concerning the Government's Misconduct.

The "chief issue" on appeal, the Panel said, was whether the District Judge abused his discretion in holding that the government's misconduct warranted dismissal of the indictment. The Panel held that the remedy was not warranted. It said that the misconduct here was not as "egregious" as that in Rodman v. United States -- where the First Circuit dismissed the indictment for misconduct of the SEC staff.* And the Panel seemed to place great significance on the asserted fact that the government's misconduct did not prejudice the defendants in the criminal -- as opposed to civil -- case against them. (Sl. Op. 4733-4734) In his concurring opinion, Judge Mansfield found the conduct of the SEC staff to be "deceitful and duplicitous," but he voted to reverse on the ground that defendants suffered no prejudice in the criminal case. (Sl. Op. 4741-4742)

* 519 F.2d 1058 (1st Cir. 1975).

We respectfully submit that the Panel overlooked key findings of the District Court; that its distinction of Rodman is based on misapprehension of both the record in this case and in Rodman; and that both the majority and Judge Mansfield overlooked substantial prejudice suffered by the defendants in the criminal case as a result of the government's misconduct.

It is important first to note that none of Judge Haight's extensive findings was challenged by the government on appeal or found by the Panel to be clearly erroneous. Yet, a reading of the majority's opinion makes it appear as if the case decided by the Panel was a case totally different from that found by Judge Haight. Briefly, Judge Haight found that two government lawyers engaged in the following misconduct:

1. They deliberately sat silent while counsel for the defendants repeatedly made it plain to them that the defendants' principal objective in bringing the matter to the SEC's attention, and in negotiating a settlement with the SEC, was to avoid a criminal reference. (District Court Opinion at 91,839-43)

2. They affirmatively represented to a lawyer, C. Leonard Gordon, that there would be no criminal reference, and Mr. Gordon communicated that representation to defendant Fields. (District Court Opinion at 91,842)

3. Although fully aware that defendants' chief objective was to avoid a criminal reference, and aware that defendants were under the apprehension that there would be no criminal reference, they deliberately withheld from defendants their intention to refer the case and the fact that they did refer the case and recommended prosecution. Indeed, they had called the United States Attorney, urged him to prosecute, and said "We really want to get" the defendants. (District Court Opinion at 91,841-43)

4. They extracted a "superb" settlement from defendants, after urging the prosecutor to delay bringing criminal charges because they admittedly recognized that defendants would not settle if they knew the case was being referred to the U.S. Attorney. (District Court Opinion at 91,843)

5. They succeeded in extracting onerous sanctions against the defendants by a course of conduct which the District Court found to be "fraudulent," "misleading," "calculated and deliberate," "intentional," and "wrongful." (District Court Opinion at 91,848-49)

6. Had defendants known that a criminal reference was being made, defendants would not have consented to the onerous sanctions imposed by the SEC. (District Court Opinion at 91,844)

7. The two SEC lawyers lied on the witness stand when they testified that they had advised counsel for the defendants that there was "no deal on criminal." (District Court Opinion at 91,840-42)

These are some of the unchallenged and undisturbed findings of the District Court. They obviously paint a far different -- and far more sordid -- picture of the government's chicanery than is reflected in the majority's characterization of the government's behavior as merely "alleged misbehavior." (Sl. Op. 4719) This picture, we respectfully submit, in and of itself permitted the District Court in the exercise of its discretion -- under the most basic principles of fairness -- to dismiss the indictment, especially in light of Judge Haight's conclusion that there was no appropriate alternative remedy and that defendants can not now be put back into the position they had occupied before consenting to the SEC's fraudulent settlement. (District Court Opinion at 91,849-50)

But more than basic fairness permitted a court of equity, on these extraordinary facts, to dismiss the indictment. It is a hornbook principle of contract law that a defrauded party is entitled to "enforcement against the fraudulent person of the kind of bargain that he represented he was making." Williston on Contracts, § 1523 at 607 (3d

ed. 1970). All the elements of common law fraudulent inducement are present here: there was a representation made, both by silence and expressly to a lawyer who communicated with the defendants, that there would be no criminal reference; the representation was found to be fraudulent; and the defendants detrimentally relied upon the representation. Therefore, even though no express agreement with the government was found here, traditional contract principles hold that an enforceable bargain was created by the fraud of the government. These principles permitted the District Court, after finding that the government committed deliberate fraud, to enforce the bargain by dismissing the indictment.

It was thus only by overlooking the actual findings of the District Court -- i.e. that there was gross fraud by the government -- that the Panel could conclude that the District Court was not empowered to grant the remedy of dismissing the indictment.

The Panel also overlooked the record facts in this case and the record in Rodman in its distinction of the Rodman decision. The Panel said (Sl. Op. 4734) that (a) Rodman presented a more "egregious" fact situation because in Rodman the government broke an express agreement to recommend against criminal prosecution and (b) the defendant in Rodman was prejudiced by the fact that he had given incriminating testimony

in reliance on that agreement.

First, it is difficult to comprehend how it is morally or legally more "egregious" for the government merely to breach a contract (as in Rodman) than fraudulently to induce a contract (as was the case here) -- or why the former warrants a broader remedy than the latter. In fact, the law has always treated fraud as more reprehensible than breach of contract and has afforded the victim of a fraud broader remedies than the victim of a breach of contract. Justice Holmes said that the only obligation created by a contract is the obligation to pay damages in the event of non-performance. Holmes, The Common Law, p. 236 (Little Brown, 1963) A party guilty of fraud -- as the government is guilty under the undisturbed findings of the District Court -- is traditionally subject to a variety of civil and criminal penalties.

Indeed, the facts in Rodman (overlooked by the Panel) were that the SEC staff failed to keep its word because it believed (erroneously) that the defendant had ceased his cooperation and thus failed to meet his end of the bargain. 519 F.2d at 1059. There was no finding in Rodman of fraud or bad faith on the part of the government. Surely the fraudulent conduct here was more "egregious" than the breach in Rodman. And in any event, as noted above,

under traditional contract principles, the government's fraud in this case itself created an enforceable bargain.

Thus, the Panel's first distinction of Rodman is based on a misapprehension of the record.

Second, the Panel was even more clearly in error when it attempted to distinguish Rodman on the ground that Mr. Rodman suffered prejudice in his criminal case, while defendants here allegedly did not, on account of the SEC staff's misconduct. The asserted prejudice in Rodman was the incriminating testimony given by the defendant to the SEC. But the record in Rodman shows that the government ultimately stipulated not to use that testimony in its prosecution of Mr. Rodman. (A. 163) Thus there was no prejudice to Mr. Rodman. Nevertheless, the District Court held, and the First Circuit agreed, that dismissal of the indictment was required -- out of "fairness." (A. 165) The same is true here: there was not the slightest showing in this case that there would have been any indictment except for Tucker's and Perlmutter's fraudulent reference and recommendation to prosecute.

Moreover, both the majority and Judge Mansfield failed to perceive that there was substantial prejudice to the defendants here in the criminal case as a result of the SEC's misconduct -- a factor that the Panel apparently regarded as critical. The most obvious prejudice of course lies in the fact that the government's misconduct was the

direct and proximate cause of the indictment. The Panel apparently rejected this as the type of prejudice necessary, so we shall not dwell on it.

The record, however, discloses substantial additional prejudice in the criminal case. Judge Haight expressly found that but for the SEC's fraud, the defendants would not have consented to the settlement, i.e., had defendants known in December, 1975 that the SEC staff already had made a criminal reference, they would not have entered into the settlement. (District Court Opinion at 91,844)

As the necessary consequence of that fraudulent conduct, the defendants in the subsequent criminal investigation lost the opportunity to negotiate with the U.S. Attorney to accept the SEC imposed sanctions in lieu of a criminal indictment. Obviously, both the SEC and the U.S. Attorney were extremely eager to obtain that settlement: the U.S. Attorney was prepared to delay a case with a statute of limitations problem in order to allow the SEC enough time to extract the "superb" settlement. The U.S. Attorney "may well"* have agreed not to prosecute (especially in a case where the statute of limitations was fast running) in exchange for the defendants' agreement to the onerous sanctions extracted by the SEC attorneys.

* Recall that the Panel sustained the indictment on the theory that the ERD transactions should have been disclosed in a TDA prospectus because they "may well" have resulted in a 16(b) recovery for TDA. (Sl. Op. 4738)

Clearly, the government's fraud deprived the defendants of a very significant negotiating opportunity in the criminal case.*

In sum, the "deceitful and duplicitous" conduct by the government entitles defendants to enforcement of the bargain they struck with the government; the government's misconduct severely prejudiced defendants in the criminal case; and Rodman is indistinguishable.

CONCLUSION

The petition should be granted.

October 16, 1978

Respectfully submitted,

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* Thus, to directly address the point made by Judge Mansfield in his concurring opinion: It was possible that the District Attorney would have transmitted his information to the SEC without restrictions. But absent the SEC's fraud, the case never would have gone to the U.S. Attorney with the defendants having already consented to onerous sanctions that the U.S. Attorney may well have accepted in lieu of indictment.

AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

PAUL R. LEVENSON being duly sworn, deposes and
says:

I am not a party to the action, am over 18 years
of age and reside at 700 Victory Blvd., Staten Island, N.Y.

On October 16, 1978, I served the
attached Petition for Rehearing upon the following
attorney(s) at the address designated by him (them) for
that purpose:

Hochman, Salkin & Deroy, Esqs.
9100 Wilshire Blvd.
7th Floor, West Tower
Beverly Hills, California 90212

Said service was made by depositing 2 true copies
of the attached Petition for Rehearing
enclosed in a postpaid properly addressed wrapper, in an
official depository under the exclusive care and custody of
the United States Post Office Department within the State
of New York.



Paul R. Levenson

Sworn to before me this

16th day of October, 1978.

Edward N. Sutton

Notary Public

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Attorneys for

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GRAND & OSTROW

Attorneys for

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